San Diego City Attorney
MICHAEL J. AGUIRRE

NEWS RELEASE

FOR IMMEDIATE RELEASE: September 27, 2007
Contact: Maria Velasquez, Communications Director (619) 235-5725 mvelasquez@sandiego.gov

CITY ATTORNEY QUESTIONS MAYOR'S MOTIVES FOR REQUESTING A COURT TO DETERMINE CUT-OFF DATE OF COSTLY PENSION BENEFITS

San Diego, CA— The City Attorney is questioning the Mayor's motives for suddenly wanting a court to determine when the cut-off date that terminated costly pension benefits for new employees took effect. The Mayor's action is suspect in light of the fact that eight months ago the City Council amended the Municipal Code to reflect the benefit plan changes which were negotiated with City labor unions in 2005 and set the benefit cut-off date at July 1, 2005. Furthermore, outside counsel hired by the City Attorney in August confirmed that the City's actions are on solid legal ground.

It is also perplexing that last Friday the Mayor would request legal advice from the City Attorney regarding "unilateral options" that the City could take to rescind $146 million in pension liability resulting from the "Purchase of Service Credit" (PSC) program which was supposed to be cost neutral to the City, but shun the legal advice the City Attorney has provided on the benefit cut-off date. Furthermore, the Mayor has not responded to the proposed ordinances the City Attorney drafted at the Mayor's request.

"Why on earth has the Mayor come forward today?" said City Attorney Michael Aguirre. "If he had serious concerns, nothing was mentioned by the Mayor when the City Council took action last January to amend the Municipal Code. I've also sent the Mayor and City Council more than a dozen memorandums since taking office requesting that action be taken to rein in these benefits which were supposed to be cost-neutral to the City."

The issue of the effective cut-off date arose on August 3, 2007, when the San Diego City Employees' Retirement System (SDCERS), through its general counsel, informed the City's Labor Relations Manager that SDCERS is using "an effective date of February 16, 2007 for the benefit changes that were negotiated in 2005," citing their own legal opinion which they released eight months after City Council acted. That legal opinion stated "SDCERS is obligated to administer benefits in accordance with its plan documents, and neither memoranda of understanding (MOU's) nor terms and conditions imposed post-impasse constitute plan documents."

The City's outside legal counsel, K&L, however, concluded "that the MOU would most likely be considered to be a 'plan document' by a court and the Internal Revenue Service because the employer and

(MORE)

the bargaining units' representatives intended for it to represent their final agreement regarding certain benefits, intended for it to be effective on a specific date, and it was ratified by the City Council. There is no claim that the MOU was void, defective or unauthorized."

Also, last Friday SDCERS announced that 15% of the City's $1 billion pension liability, or $146 million, is a direct result of the PSC program. The program allowed City employees to purchase up to five years of retirement credits for years not actually worked at a grossly discounted price.

In a news release issued by the Mayor's Office the Mayor said he was "angered by this revelation" and found it to be "completely unacceptable."

To date, the City Attorney's Office has issued several memoranda and reports (January 7, 2005; February 11, 2005; February 22, 2005; April 27, 2005; January 4, 2007; July 10, 2007; July 30, 2007; August 10, 2007; and September 7, 2007) urging that the PCS program be rescinded.

The City Attorney's Office also brought the discounted PSC program to the attention of the public and City Council through its release of Interim Reports No's. 2, 3, & 12. Interim Report No. 12, "Report on Scheme to Price San Diego City Employees' Retirement System (SDCERS) Pension Service Credits Below Cost in Violation of California Law" was released on September 18, 2006 and outlined how purchase of service credits were priced below their actual cost. The Report concluded:

- The San Diego City Employees' Retirement System violated their fiduciary duties to the pension system by knowingly and willingly pricing the years of service credits below their cost to the City, thereby placing the financial security of the system in jeopardy; and
- It is the City Attorney's considered judgment that legal action needs to be taken to correct the misappropriation of public funds used to subsidize the illegal pricing scheme for the Pension of Service Credit program.

BACKGROUND:

The PSC program was originally created by the City to benefit members of the military who left City service to serve. For instance, if a member of the military was called to active duty for two years, that employee could purchase the two years missed upon returning to the City.

The program was expanded in 1996, as a part of the Manager's Proposal I (MP1) deal between the City and the SDCERS. The new program expanded the PSC program and enabled all City employees to purchase up to five years of service credits – without actually working those years. The program was incorporated into the City of San Diego's Municipal Code.

According to MP I, the program was supposed to be cost neutral for the City and the years of service were supposed to be priced so the employee would pay the full price of the benefit, both the employee's cost and the City's cost.

(MORE)

However, on March 21, 1997, the SDCERS Board priced the years far below what it would cost the City to provide the benefit. Regardless of an employee's salary, years of service, or age--all factors that should have been considered in structuring the pricing formula--General and Legislative Members were charged 15 percent of current pay per year purchased. The corresponding cost for Safety Members was 26 percent of current pay. Under the pricing formula, a general member earning $100,000 per year could buy a year of pension credits for $15,000. The cost would be $26,000 per year purchased for a safety employee.

The program became wildly popular as City employees sought to cash in on the benefit. It was not long until SDCERS officials realized that the discounted pricing formula was creating a debt to the pension system. However, even after discovering this fact, the SDCERS Board did not revise the pricing formula for several years.

Both the SDCERS actuary and its Assistant Administrator warned the SDCERS Board that the pricing formula needed to be revised upward if the program was to be cost-neutral to the City. Finally, on August 15, 2003 the SDCERS Board voted to raise the per year cost of the PSC program to 27% for General Members, 37% for Safety Members, and 50% for Legislative Members. However, the SDCERS Board allowed employees who submitted their application before November 1, 2003, to purchase service credits at the lower, former price. As a result, hundreds of additional years of service were purchased at the discounted rate and added to the pension system's debt.

During labor negotiations in 2005, it was agreed that the program would be closed to new City employees hired after 1 July 2005.

On the legal front, on August 3, 2007, Superior Court Judge Jeffrey B. Barton ruled against the City in its lawsuit seeking the rescission of illegal and unfunded pension benefits granted to City employees by the City Council in 1996 and 2002 due to statute of limitation considerations. Judge Barton, however, never ruled on the merits of the City's claim. The City Attorney believes that Judge Barton's decision is not supported by the law or the facts and is, therefore, appealing the court's decision.

###